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## Russia's foray into crypto in the face of sanctions?

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The attack on Ukrainian soil by Russian forces has not only triggered a new phase of international relations but has transformed the international financial system. G7 members, including the EU, and like-minded partners released a flood of sanctions and pledged to remove strategically important Russian banks from the SWIFT messaging system used to process bank to bank payments. This has led many to wonder: With Russia thrown off the international banking system, is it likely to lurch towards crypto? And if so, what does this mean for businesses that are holding and/or using crypto?

### *Russia & Crypto*

That is an area of concern and much public debate. Although crypto transfers are traceable, there is a possibility that designated Russian persons and entities could turn to cryptocurrencies to try to evade sanctions. This is particularly true for decentralized exchanges (DEX) and decentralized finance (DeFi) platforms, which use smart contracts to execute transactions. DEX and DeFi are not currently regulated for anti-money laundering or counter-terrorist financing (AML/CFT), meaning that they carry out no customer due diligence, sanctions screening, monitoring of transactions or any other related measures. Crypto transactions are pseudonymous and without verification of identity, it is difficult to know who the actual holder of a crypto wallet is. The use of VPNs further complicates this as does the existence of privacy coins. We have seen circumvention of sanction using crypto with Iran where, according to a study by Elliptic (<https://www.elliptic.co/blog/how-iran-uses-bitcoin-mining-to-evade-sanctions>), approximately 4.5% of Bitcoin mining takes place. ). A report by a think-tank attached to the Iranian Presidency has highlighted the ability of bitcoin to circumvent sanctions (<https://iranwire.com/en/features/9084>). Reports indicate that Russia has the world's 3<sup>rd</sup> largest crypto mining industry (<https://www.themoscowtimes.com/2022/02/21/crypto-a76437>), and there is the possibility that similar to Iran, Bitcoin and other cryptocurrencies could be used to pay for imports. Additionally, both Chainalysis (<https://blog.chainalysis.com/reports/2022-crypto-crime-report-preview-russia-ransomware-money-laundering/>) and Solidus Labs (<https://www.coindesk.com/video/recent-videos/russian-banks-cut-off-from-swift-role-of-crypto-as-the-war-with-ukraine-escalates/>) have indicated that Russia could turn to cyberwarfare and ransomware to raise funds in cryptocurrencies. However, experts from TRM Labs have flagged that there is not enough liquidity in the crypto market to process the size and value of transactions required to prop up the Russian government. (<https://www.cnbc.com/video/2022/03/01/crypto-wont-be-able-to-help-russia-evade-sanctions-trm-labs.html>) This further raises the question on whether Russian actors subject to sanctions, some of which are billionaires, would be able to access enough cryptocurrencies to process their transactions, which would probably be high-value, undetected. There are also "whale watchers" who track and publish details of high value transactions on the Ethereum and Bitcoin blockchains, alerting the community to unusually large payments.

There is a much higher possibility that average Russia citizens will turn to crypto to try to safeguard her or his wealth in the face of massive inflation, extreme currency fluctuations and the inability to access cash, make payments, or move funds in and out of Russia. There is currently a ban on the use of cryptocurrencies to make payments in Russia and earlier this year, the Central Bank of Russia proposed an all-out ban on cryptocurrencies and mining. That, however, has not stopped average Russian citizens from holding cryptoassets: "According to the Russian government, \$5 billion in transactions are conducted using cryptocurrencies every year in the country, and its population of 144 million owns about \$26.5 billion worth of crypto in over 12 million cryptocurrency accounts." (<https://www.themoscowtimes.com/2022/02/21/crypto-a76437>) However, a challenge remains in converting crypto to fiat due to the sanctions in place and risk aversion by banks to process payments originating from Russia, which may make it challenging to pay for real world goods and services from vendors that do not accept crypto. However, just over a week ago, Russia introduced a draft crypto bill to apply

FATF AML/CFT standards to VASPs, with the Finance Ministry laying the groundwork to regulate crypto. <https://www.coindesk.com/policy/2022/02/21/russian-government-introduces-crypto-bill-to-parliament-over-central-bank-objections/> This could lead to wider adoption by vendors so that they can get paid as the value of the Russian ruble tumbles. Russia has also recently successfully piloted a central bank digital currency (CBDC), the digital ruble, which was expected to go live late last year and is moving forward with plans to roll this out in mainland Russia. <https://cointelegraph.com/news/digital-ruble-trial-goes-live-as-bank-of-russia-insists-on-bitcoin-ban>

### *UK Businesses*

With regards to what does this mean for businesses that are holding / using crypto, it is essential that transactions are made with known counterparts, via centralized exchanges that are subject to AML/CFT regulation, and that a bit of footwork is conducted to try to check the public wallet addresses of incoming / outgoing payments where possible so that they do not fall foul of sanctions themselves. In the coming weeks, there will be a need to strike the right balance between legitimate, non-sanctioned business and access to funds by civilians not involved in the conflict.

Immediate measures that firms operating in the crypto space may wish to consider include:

- Sweeping their customers base against sanctions lists
- Understanding beneficial ownership structures and limits on ownership and control of legal entities to identify entities that may not be directly sanctioned but owned and/or controlled by a sanctioned entity / individual
- Identifying customers who have a high volume of business in industries subject to sanctions in Russia or who have large Russian exposure
- Identifying any sanctions licensing opportunities
- Identifying Russian exchanges and carrying out enhanced monitoring of value transfers
- Spot testing blockchain monitoring technology to ensure that is effectively working
- Identifying suspicious activity such as hops, use of mixers and tumblers, transactions linked to ransomware, or discrepancies between IP address associated with a customer's profile and IP address where transactions are being triggered
- Checking wallet addresses against sanctions lists
- Turning on geolocation tools and IP addresses to identify and investigate IP addresses in cities identified in sanctions designations subject to a risk-based approach
- Identifying other metadata associated with transactions and logins that could be screened such as mobile device information (IMEI)
- Blocking assets of sanctioned persons
- Identifying reporting authorities in different jurisdictions
- Developing templates to report identified blocked transfers, customers and assets to relevant reporting authorities in different countries
- Reporting blocked virtual currency and identified transactions to the relevant authority within the specified timeframe
- Reviewing record keeping arrangements to ensure that full and accurate records are held on transactions, customers and licenses subject to sanctions for the relevant time required to keep records by the sanctions issuing authority
- Assessing whether there are dual reporting obligations to national FIUs to comply with anti-money laundering laws
- DeFi and DEX should consider exploring ways to prevent their services being used to facilitate sanctions payments as depending in where they are incorporated or the nationality of their directors, beneficial owners and employees, they may also be subject to complying with sanctions as nationals of countries issuing designations
- Maintain copies of reporting to senior management and Board discussions around sanctions risk management

### *Reporting*

Firms must ensure that they report blocked property and rejected transactions to relevant authorities within a specific timeframe.

For example, in the US:

- Initial blocked property must be reported within 10 days after the property is blocked
- Rejected transactions must be reported within 10 days of the transaction being rejected

The table below includes details of the designating and reporting authorities in G7 countries:

Country	Body Responsible for Issuing Sanctions Designation	Report Frozen Assets to
US	OFAC	OFAC <a href="https://home.treasury.gov/policy-issues/financial-sanctions/ofac-reporting-system">https://home.treasury.gov/policy-issues/financial-sanctions/ofac-reporting-system</a>
UK	FCO	OSFI <a href="https://www.gov.uk/guidance/suspected-breach-of-financial-sanctions-what-to-do">https://www.gov.uk/guidance/suspected-breach-of-financial-sanctions-what-to-do</a>
EU	Relevant competent authority in each EU country (Central Bank or Ministry of Foreign Affairs equivalent)	Dependent on jurisdiction – law enforcement authority, FIU or Central Bank
Australia	DFAT	AFP <a href="https://www.afp.gov.au/contact-us/report-commonwealth-crime">https://www.afp.gov.au/contact-us/report-commonwealth-crime</a>
Canada	Global Affairs Canada	RCMP <a href="https://www.international.gc.ca/world-monde/international_relations-relations_internationales/sanctions/faq.aspx?lang=eng#a18">https://www.international.gc.ca/world-monde/international_relations-relations_internationales/sanctions/faq.aspx?lang=eng#a18</a>
Japan	MoFA	???

Certain countries may require that blocked property to be reported on an annual basis.

Firms should remain aware of requests from authorities for ad hoc requests for information from sanctions issuing authorities.